MEMORANDUM FOR
THE CALIFORNIA STATE TEACHERS' RETIREMENT SYSTEM

Washington Monthly Report

The impeachment proceedings that had ground the Senate to a halt are now over. Freed of having to sit at their desks on the Senate Floor for hours on end, Senators burst out of the Senate chamber and headed to the airport for the President's Day recess with a rush not seen since Spring break in Ft. Lauderdale.

It will be difficult to assess just how the whole impeachment proceeding may have altered the legislative landscape, if at all, until Congress returns from its week-long President's Day recess. However, for now one must proceed from the premise that both sides will be anxious to pursue an active legislative agenda in an effort to reclaim the voter's attention. How well the two sides can work together on contentious issues such as Social Security reform is another matter.

Mandatory Social Security for New State and Local Workers

As we had anticipated, the President's Budget for FY 2000 released on February 1 **did not** include mandatory coverage for new State and local workers as part of the President's Social Security reform initiative. This is an important accomplishment because it must be our objective to stave off every serious Social Security reform proposal that is laid on the table. All indications are that the White House heard vociferous opposition from a range of groups in California and a number of other key States. Inclusion of mandatory State and local coverage in the President's proposal would have provided important political cover for Congressional Democrats and Republicans alike, and would have made our efforts to stave off such a proposal on Capitol Hill even more difficult. On the Congressional front, in recent informal remarks the Chairman of the House Ways and Means Chairman, after an "on the one hand, on the other hand" analysis, cast some doubt on whether a mandatory State and local coverage provision would be included in a Social Security reform plan adopted by his committee.

However, one should only bask in this glory for a moment. True, the White House has now become sensitized to the opposition in California and elsewhere, but the real reason mandatory State and local coverage was not included is because the Administration did not need the revenue from State and local governments (or from anyone else, other than the Federal taxpayer) to finance its reform plan and therefore could duck all of the hard choices regarding programmatic changes in Social Security, such as benefit cuts and payroll tax increases. Senior officials of the White House Office of Management and Budget indicated later at a briefing for State and local government groups that, while mandatory State and local coverage was off the table for now, the President's plan extended the Social Security trust fund's solvency to the year 2055, and if the decision ultimately is made to extend solvency for the full 75 years called for by some experts, mandatory coverage could come back into play.

The President's plan to dedicate 62 percent of the projected Federal budget surpluses for the next 15 years to restore Social Security's solvency has come under fire from Congressional Republicans in a number of respects. First, there has been the criticism that the "cash" from the "surplus" is merely moving in a circle. At the end of the day, the surplus revenues would have been used to pay down Federal debt in private hands, with the Social Security trust fund ending up with an IOU from the Federal government's general revenue fund for a like amount. There would be no net reduction in Federal debt, with debt having been shifted merely from the hands of private investors to the government's hands in the person of the Social Security trust fund. Congressional Republicans also worry that for the first time the Social Security trust fund would have an entitlement claim against general Federal revenues, even if some of the budget surpluses failed to materialize in the future.

In addition, the President's plan to invest approximately 15 percent of the projected Federal budget surpluses (a quarter of the 62 percent set aside for Social Security) in equities in the form of direct market investment by the Social Security trust fund has encountered widespread opposition. This opposition ranges from Fed Chairman Alan Greenspan who fears political interference and no net increase in savings to many on Capitol Hill who fear the implications of direct equity interests by the Federal government in private business, as well as opposition from those who have embraced the concept of channeling a portion of Social Security revenues into private accounts to be managed by the worker.

Mandatory State and local coverage could easily reappear in the Social Security reform debate if any of a variety of possible scenarios occurs. First, the President's plan could fall victim to the "cash moving in a circle" criticism and those on Capitol Hill demanding the restoration of solvency by means of programmatic changes in Social Security. Second, the decision could be made to extend the trust fund's solvency not just from the year 2032 to 2055, but instead for the full 75 years to 2075. Third, the proponents of private accounts could win out on at least some partial form of privatization, which is likely to create an immediate near-term revenue gap as revenues previously passed through to pay current retiree benefits are diverted into private accounts for current workers.

To make every effort to stave off mandatory State and local coverage as an option in the Social Security reform debate, we are working closely with STRS staff in carrying out a comprehensive legislative strategy, which includes grassroots efforts in California, ongoing contacts in Washington with key Californians in Congress, and coordination with interested California government groups in Washington and the national groups of State and local employers or employees.

First, STRS staff is well underway in generating a broad-scale grassroots effort in California, including superintendents, school boards, school business officers, community college leaders, and active and retired employee groups across the State. It is crucial that all of the 52 members of the California Congressional districts hear from home as to exactly the consequences that mandatory coverage will visit upon the budgets of their school districts and community colleges and the retirement security of teachers in their area.

Second, during STRS staff's various trips to Washington, we met with the offices of a broad range of key Members of the California Congressional delegation from both parties. These include Rep. Bob Matsui (D-Sacramento), who is the ranking Democrat on the House Ways and Means Social Security Subcommittee. Rep. Matsui has agreed to be the point person along with influential Republican Ways and Means Member Rob Portman (R-Ohio) in opposing mandatory State and local coverage proposals in the House Ways and Means Committee that would be the first stop for any Social Security reform proposal.

In addition, we have briefed the other senior Californians who serve on Ways and Means -- Reps. Bill Thomas (R-Bakersfield), Pete Stark (D-Fremont), and Wally Herger (R-Redding) -- on the adverse impact that mandatory coverage would have on education, including particularly the ongoing class-size reduction efforts, in California. Finally, we have made a special effort to reach out to key California Republicans with ties to the Leadership, including: Rep. David Dreier (R-Covina), who is now Chairman of the House Rules Committee through which any House Ways and Means Social Security reform proposal would have to pass before reaching the full House of Representatives; Rep. Jerry Lewis (R-Redlands), who in effect serves as the "dean" of the California Republican delegation in Congress; and Rep. Buck McKeon (R-Santa Clarita), who is a former school board president and serves as a senior Member of the House Education and the Workforce Committee which has jurisdiction over education issues in the House. We also have been in touch with a broad range of Democratic Members of the California Congressional delegation.

To coordinate with the other affected California government groups that are active on the issue, we have become part of an informal California working groups hosted by the California League of Cities and the California Association of

Counties to pool legislative intelligence, coordinate message and handout materials, and to divide up assignments for contacts with the California Congressional delegation. Representatives from the Washington offices of the California State Senate and the Governor also have been participating in these meetings. We are working with STRS staff and this California working group on a joint letter from all of the affected California groups to all 52 Members of the California Congressional delegation and the two California Senators.

On a related California front, we have been coordinating with STRS staff on a joint resolution against mandatory State and local coverage to be adopted by the California Assembly and State Senate and sent on to the President, Congressional leaders, and the California delegation.

On the Washington front, we also have been participating with both the coalition opposing mandatory coverage (Coalition to Preserve Retirement Security) and an informal working group of the Washington-based national groups of State and local government employers, plans, and employees in an effort to forge a comprehensive legislative strategy, to pool intelligence, to coordinate message, and to coordinate legislative contacts.

Finally, in response to the Teachers' Retirement Board's direction, we have prepared and provided to STRS staff a draft statement for Emma Zink, as Chair of the Board, responding to the assertions made by Fed Chairman Greenspan and elsewhere that the performance of State and local government retirement systems is hampered by "political interference". Opponents of the President's proposed direct equity investment of Social Security trust monies have asserted that State and local plan performance has lagged private plan performance because, after adjusting for risk and portfolio composition, there remains a shortfall that can only be ascribed to "political interference" with public plan investment decisions.

The thrust of Chairperson Zink's draft statement is that, while CalSTRS does not intend to inject itself into the larger debate over Social Security privatization, as one of the largest State retirement systems in the country STRS feels compelled to respond to the suggestion that State and local plans and their governing bodies have failed to fulfill their fiduciary responsibilities. The statement points out that the Teachers' Retirement Board has fully discharged its fiduciary responsibilities to manage the retirement plan for the exclusive benefit of its 600,000 active and retired teacher members, managing the plan to operate on an essentially fully-funded basis to pay out almost $3 billion a year in benefits that have been pre-funded from employer and employee contributions and investment returns. Once Chairperson Zink's draft statement is finalized, it can be filed with the appropriate Congressional committees or otherwise circulated as the Board wishes.

Elk Hills Compensation

We are continuing to work with Rep. Bill Thomas (R-Bakersfield) to pursue the Congressional appropriation that is necessary to fund the second $36 million installment of Elk Hills compensation that is due for FY 2000. Unless we actively pursue this appropriation, this $36 million installment -- which remains very controversial -- is unlikely to be forthcoming, and future installments of the $324 million in total Elk Hills compensation may be jeopardized.

The President has included in his proposed budget for FY 2000 submitted to Congress on February 1 a request for the $36 million appropriation for Elk Hills compensation. The Congressional appropriators have vowed a return to "regular order" in which the appropriations decisions are made by the relevant Subcommittee, in our case the Interior Appropriations Subcommittee, rather than the end of session free-for-all last year. Last year, Congressional leaders negotiated a huge omnibus appropriations package with the White House, which gave us the opportunity to have the White House Chief of Staff and the Deputy Chief of Staff intervene on behalf of the Elk Hills funding.

Rep. Thomas has determined to get the Congressional appropriators' attention by assembling a letter to the Chairman of the full House Appropriations Committee and the Chairman of the Interior Appropriations Subcommittee in support of the Elk Hills appropriation from the entire California House delegation. This entailed our writing and calling -- in many cases, multiple times -- the entire 52-person delegation. "Herding cats" is the expression that comes to mind. The separate Democratic and Republican arms of the delegation also circulated the letter in their caucuses. Finally, after all of these efforts, we have assembled the entire California House delegation on the letter, a feat rarely accomplished.

We will press on with the Elk Hills legislative effort, consistent with mandatory Social Security as the top Federal legislative priority for STRS.

Broad Pension Liberalization Legislation

The tax proposals in the President's FY 2000 budget include a broad series of proposals to facilitate retirement savings and pension portability, particularly in the State and local government retirement plan sector.

The President's budget picks up a number of the portability proposals which the public plan sector has been pursuing. Tax-free rollovers would be much more broadly allowed: between tax-qualified plans (such as the STRS Defined Benefit and Cash Balance Plans) and section 403(b) annuities; from traditional (*i.e.*, non-Roth) IRAs to tax-qualified plans or section 403(b) annuity plans; from section 457 deferred compensation plans to traditional IRAs; direct rollovers from section 403(b) annuities or section 457 deferred compensation plans attributable to prior State or local employment in order to purchase permissive service under a governmental defined benefit plan; and rollovers of after-tax employee contributions would be permitted for the first time.

In other changes, contributions to IRAs could be made through payroll deductions. In addition, leave under the Family and Medical Leave Act would be counted toward any period necessary to become eligible to participate in the retirement plan as well as toward vesting. The plan would not be required to provide a benefit accrual for such a leave period.

Reps. Rob Portman (R-Ohio) and Ben Cardin (D-Md.) are expected to pursue the portability proposals cited above as part of their broad-ranging pension liberalization package which may be introduced shortly. The fate of these pension proposals will depend on whether a broad tax bill is adopted this year.

John S. Stanton

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